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Bankruptcy problems;; Letter-Bulletin, 6

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BANKRUPTCY PROBLEMS—*Letter-Bulletin 6*

To MEMBERS AND ASSOCIATES:

In response to a demand by the business public for a stronger national bankruptcy act and for more rigid enforcement of the law, Congress has enacted, and the President has signed, a measure containing a carefully prepared series of amendments to the bankruptcy statute. In addition, the United States Supreme Court has strengthened its General Orders in Bankruptcy, which define the procedure under the law.

Pleas for a stronger law and for stringent enforcement came from a business public irritated by heavy losses and great inconveniences due to misuse and weaknesses of the bankruptcy procedure. There was a carefully conceived movement to obtain a strict bankruptcy procedure, closer supervision of administration by courts, and swifter, surer punishment of offenders.

The accountancy profession helped to crystallize the demand for improvement by laying before business men and their organizations facts relative to unsatisfactory bankruptcy conditions. Public accountants coöperated with the credit men of the country in this work, recognizing in it an economic undertaking of utmost concern to all.

Your Committee on Public Affairs presents in this letter-bulletin (the sixth in its series over a period of two years), the essential facts relative to the changes in the bankruptcy procedure which it is believed will reduce fraudulent bankruptcies and throw additional safeguards around the interests of creditors, without weakening the protection given to debtors.

Continued coöperation of practising accountants, in ways indicated in this letter-bulletin, will be helpful. Your committee believes that there is opportunity here for a valuable public service.

THE COMMITTEE ON PUBLIC AFFAIRS

Contents

HOW ACCOUNTANTS MAY HELP

You can aid in presenting information to the business public relative to bankruptcy evils and the amendments of the law enacted for the purpose of correcting the conditions of which complaint has been made.

Circulation of this information may be accomplished in the ways enumerated here:

1. Distribute this letter-bulletin through chambers of commerce, trade bodies, banking institutions, civic, business and professional organizations.
2. Serve on committees of such organizations as those listed above, appointed for the betterment of bankruptcy conditions.
3. Make public addresses on bankruptcy ills and their cure, supplementing the material presented here with facts from your own experiences.
4. Write articles for newspapers and other publications, based on this letter-bulletin and on your own experiences.

Prior Letter-Bulletins Available

Copies of the following letter-bulletins issued by the Committee on Public Affairs are available for the use of accountants, attorneys, bankers, business men, credit men, civic, public and quasi-public organizations, trade bodies, schools, libraries, chambers of commerce, and boards of trade:

1. "*Arbitration*"
   —a letter-bulletin of 8 pages discussing the use of arbitration for the settlement of commercial disputes.
2. "*The Crime Tendency*"
   —a letter-bulletin of 16 pages discussing the prevailing crime tendency as related to financial affairs.
3. "*Credit Frauds*"
   —a letter-bulletin of 32 pages, discussing the subject of credit frauds, in three principal parts—misrepresentation, diversion of assets, and bankruptcy.
4. "*Tax Simplification*"
   —a letter-bulletin of 12 pages discussing the simplification of tax laws.
5. "*Federal Arbitration*"
   —a letter-bulletin of 16 pages discussing the new federal law and the progress made by the arbitration movement in various states.

BANKRUPTCY PROBLEMS

Accountants Help Remedy Serious Conditions Caused by Misuse of Law

DISCHARGE of debts by bankruptcy proceedings—a relief provided under the law from humanitarian and economic motives—has given rise to vexing problems in American business life, because of the misuse, by the unscrupulous, of a law intended to enable honest debtors to rehabilitate and reëstablish themselves in business and society, as well as to protect the interests of their creditors.

Need of a bankruptcy law is universally recognized, in view of the large percentage of undertakings that fail because of the unavoidable hazards of business. Business men, however, have rebelled against the misuse of the law by business crooks who, under the cloak of a statute intended to protect the unfortunate, have succeeded in stealing increasingly large sums by carefully planned, fraudulent bankruptcies, and by concealment of assets. These business criminals have brought even the law itself into disrepute.

Business men were faced by the necessity of strengthening the bankruptcy law so as to put a stop to its misuse. They felt that if conditions were not bettered the bankruptcy law eventually would be repealed, and the country thrown again into those chaotic conditions which prevailed under state insolvency laws when there was no national act. Some economists would have gone further than amending and strengthening the present act; they advocated fundamental changes in the law, or an entirely new law. But the need for at least a strengthening of the present act was conceded on all sides.

The conditions described resulted in a well conceived and vigorously prosecuted movement, participated in by federal judges, attorneys, credit men, accountants and business men, for a stronger bankruptcy law and for more stringent enforcement of its provisions. Three important developments in this undertaking during the past fifteen months may be recorded:

First, promulgation by the United States Supreme Court on April 13, 1925, of seven new General Orders in Bankruptcy, having the full force of law, and designed to correct evils that had crept into the administration of the bankruptcy act.

Second, creation of a protective fund of one and one-half million dollars by the National Association of Credit Men for the investigation of alleged credit and bankruptcy frauds and for the prosecution of offenders.

Third, enactment by Congress of amendments to the national bankruptcy act. A measure was passed by the Senate May 18, 1926, and by the House of Representatives May 19th. The President approved it May 27th. By the provisions of the act it becomes effective three months after its approval, or on August 27, 1926.

Federal Judges Take Action

Promulgation of the new General Orders in Bankruptcy by the United States Supreme Court came about as the result of studies of bankruptcy problems by some of the most eminent jurists of the country, headed by William Howard Taft, Honorable Chief Justice of the United States Supreme Court. They are given in full on page 10 of this letter-bulletin.

The raising of a million-dollar protective fund by the National Association of Credit Men was completed in June, 1925. The fund has since been enlarged by an additional half million dollars. Aid was given in the campaign by this Institute and by the accountancy profession. Generous recognition of the service rendered by the Institute was given in a resolution adopted by the National Association of Credit Men, at its annual meeting in Washington, D. C., in June, 1925.

The real need of an effective bankruptcy law, founded on equity and humanity, is evidenced by the repeated efforts, in the face of many failures, which Congress has made to obtain one. Laws were enacted in 1800, in 1841, in 1867 and in 1898, each one, with the exception of the last, being repealed after a short trial. The law of 1898 was passed largely through the efforts of the credit men of the country. That act, its authors believed, was so drawn as to avoid many of the evils and scandals that led to the repeal of the earlier bankruptcy laws. The law's proponents were correct, in a large measure, in their belief. Harold Remington, of New York, an attorney, in speaking of the law of 1898 at a hearing before the Committee on Judiciary of the House of Representatives, said:

> "This present law was one of the most carefully framed jurisprudences, if we might call it such, that we have ever had touching that most important thing—business failures; and that it is a very wisely framed law in its fundamentals is manifest when we consider that notwithstanding it touches every part of the country, and notwithstanding the fact that it is every day tested in the courts, it has stood during the last 16 years without any amendment excepting the immaterial ones...."

Judges, business men, accountants, credit men, attorneys and government officers were agreed, however,

that the national bankruptcy act needed strengthening.

John G. Sargent, United States attorney general, in his annual report of December 9, 1925, urged the amendment of the bankruptcy law, saying, "I regard it as important that the criminal statutes relating to bankruptcy be modified. . . . "

Studies of means of preventing bankruptcies, as well as of means of improving the administration of the law when bankruptcy does come, have been made by public accountants. Accountants often act as receivers and as trustees, and their services are much in demand by receivers and trustees. Accountants occasionally have at their command means of preventing fraudulent bankruptcies. They are also often able to discover the advance indications of conditions that lead to honest bankruptcies. They are especially fitted to assist in marshalling and conserving assets and in distributing them equitably.

But it is not only with prevention of fraudulent uses of the law, with the punishment of offenders, with the administration of bankrupt estates, and with the elimination of losses caused by these frauds, that public accountants are concerned. They hope to see such a practice established as will enable accountants, bankers and attorneys to assist firms and individuals who are in financial difficulties in such manner as to prevent bankruptcy.

Accountants Study Conditions

A special study of bankruptcy conditions and problems was begun by the American Institute of Accountants through its Bureau of Public Affairs two years ago, and individual members and associates of the Institute have coöperated with other organizations for even a longer period in making such studies. Many accountants have made independent investigations, and have communicated their findings to the business public by means of published articles and public addresses.

This Institute, as a part of its public service programme, discussed the weaknesses of the bankruptcy system in a letter-bulletin entitled "Credit Frauds" issued April 10, 1925, in which bankruptcy was described as the third stage in credit frauds, following first, misrepresentation as to assets and second, diversion of assets. Examples of bankruptcy frauds were given.

During 1923 and 1924 a special committee of the Merchants' Association of New York made a detailed study of the workings of the bankruptcy act, especially in the City of New York, and prepared a comprehensive report as to changes which it deemed desirable in the law and in the court procedure under the law. Other chambers of commerce, trade associations, and business men's organizations from time to time have made similar studies.

Robert H. Montgomery, an Institute member, served on the Committee of the Merchants' Association of New York which reported on bankruptcy conditions and desirable changes. Much of the information laid before this committee was obtained from the library of the American Institute of Accountants and several articles discussing bankruptcy problems were published in the Journal of Accountancy.

Simon Fleischmann, an attorney, of Buffalo, New York, chairman of the Special Committee on Practice in Bankruptcy Matters of the American Bar Association, in the hearing on the amendatory act before the Judiciary Committee of the House of Representatives, on January 19, 1926, said:

Problem Beset With Difficulties

"In approaching this subject, we found it beset with differences and conflicting views—and I may even say a complaining attitude toward it by the public and its representatives."

Mr. Fleischmann's committee reported a proposed bill to the American Bar Association at its annual meeting in September, 1925, held in Detroit. The Association without a dissenting vote adopted a resolution approving the bill.

Conferences on the bill were held by the bar association's committee with representatives of the National Association of Credit Men and of the Commercial Law League of America, as a result of which some changes suggested themselves, and compromises were made. They were embodied in the Michener bill, which went before Congress carrying the endorsement on the American Bar Association, numbering more than 25,000 members; of the Commercial Law League of America, numbering about 10,000 members; and of the National Association of Credit Men, numbering about 30,000 members. The bill later became law in substantially the form in which it emerged from these conferences.

The amendatory measure was carefully scrutinized by the United States Department of Justice, both in its criminal and its civil divisions, before it was passed by Congress.

Accountants Continue Public Service

Through the publication of this current letter-bulletin—No. 6 in the series of the Bureau of Public Affairs—the American Institute of Accountants carries on its public service with relation to the betterment of bankruptcy conditions. Besides familiarizing themselves with the changes brought about in the law, public accountants may perform a worth while public service by acquainting business men and organizations with the new provisions of the law, and with their effect on bankruptcy procedure.

DEFECTS IN BANKRUPTCY PROCEDURE OF WHICH COMPLAINT WAS MADE

Collusive Petitions, Fraudulent Compositions, Annoying to Business Men

THE primary evils of which complaint was made in the bankruptcy law and in the administrative practice which had grown up under it were:

(1) Collusive petitions.
(2) Fraudulent compositions.
(3) Easy discharges.
(4) Insufficient criminal provisions and lack of prosecution.
(5) Unlawful preferences.
(6) Delays in settling estates.

Practically all the complaints against the law and practice may be classified under one or more of the six general headings listed above.

Even a cursory examination of the complaints shows that society must protect itself, not merely against the dishonest bankrupt, but against the dishonest creditor as well. Without the connivance of creditors—usually those who have been given preferences—and of others, the dishonest bankrupt could not stage self-conducted bankruptcies and consummate fraudulent compositions.

Purposes of Bankruptcy Law

Discharge of debts by bankruptcy proceedings is a legal process for which provision is made by society to care for its business failures. The purpose of the bankruptcy law is not to collect debts, but to marshall and conserve assets; to relieve the honest bankrupt of a permanent disability to transact business because of the unfortunate condition in which he finds himself; and to protect, so far as is possible, the interests of the bankrupt's creditors.

Faulty administration of the law, rather than defects in the law itself, was pointed to by credit men as the source of many complaints. The faulty administration complained of must be considered as a part of the procedure, and may be treated apart from the alleged defects in the law itself.

The evils of which business men complained will be discussed here briefly. Some knowledge on the part of the reader of the provisions of the law is taken for granted.

Collusive Petitions

Collusive petitions are those filed at the request of or on behalf of the debtor, either directly or indirectly, in involuntary cases.

A dishonest business man, owing many debts, may himself arrange for a bankruptcy proceeding in order to free himself of his debts. He may stage the whole affair himself, through dummy creditors, sometimes created through fictitious debts; or he may have the assistance of friends who often obtain from creditors assignments of their claims.

The collusive petition brings about the voluntary-involuntary proceeding, in which the bankrupt himself masquerades in court as the petitioning creditor, being represented by persons holding assigned claims, as creditors.

The bankrupt himself, or his friends, suggests the man for receiver, if one is found necessary, and may control the election of a trustee, as well as the designation of the attorneys for the receiver and trustee. Under these conditions no very searching examination for fraud, no very thorough investigation of the bankrupt's affairs, is made, and no effort follows to discover and punish violations of the bankruptcy act, such as concealment or diversion of assets. Management of the estate remains practically in the hands of the bankrupt himself.

It all results in a very easy and not unpleasant legal clearance from debt, on a very low percentage basis, the majority of creditors defrauded being honest business men.

Fraudulent Compositions

Compositions, or settlements with creditors by debtors on a basis agreed to by the creditors, frequently are used either to prevent adjudication in bankruptcy, or to delay proceedings after adjudication. Though safeguarded in many ways, the composition procedure has been greatly abused.

The most flagrant instances of fraudulent compositions are those effected with the connivance and aid of creditors. Compositions are susceptible to fraud chiefly in that they do not always manifest all the payments, or promises of payments, made by the debtors or bankrupts.

Frequently the acceptance by the smaller creditors of the composition agreement is obtained through the solicitation and urging of the larger creditors, without any thorough investigation of the affairs of the bankrupt or searching examination or even questioning.

Thus, some creditors, by private agreement, obtain preferences at the expense of other creditors, and the bankrupt or debtor frequently is enabled to conceal and retain assets. The wisdom of the provisions of the law which relate to compositions has been seriously questioned.

Easy Discharges

Bankrupts who have failed to comply with ordinary business usages and have not met the most fundamental requirements of the bankruptcy law have often found little or no difficulty in securing discharges from bankruptcy. Until a bankrupt secures a discharge he can not again engage in business, or accumulate prop-

erty. Title to all his property is vested in the trustee. Thus, refusing a discharge is one form of punishment which may be inflicted on a dishonest bankrupt, but complaint was made that it was seldom invoked, even in flagrant cases.

Failure to keep proper or ordinary books of account, fraudulent disposition of property shortly in advance of bankruptcy, concealment of assets, destruction of records, and obtaining money on false financial statements—these are some of the acts by a bankrupt which can be made the basis of opposition to a discharge. Complaint was made that these provisions are too weak, and that they were not often applied, with the result that, in spite of the law, many bankrupts were given discharges and permitted to reënter business, even though they had flouted the provisions of the law and defrauded creditors.

It is an expensive undertaking to investigate the affairs of a bankrupt for the purpose of discovering facts to prevent a discharge. Such an investigation requires initiative on the part of some creditor or official. Opposition to a discharge can be made only by the preparation of legal papers and by the appearance in court of attorneys representing creditors, the referee, or the trustee, armed with facts as to the alleged wrongful acts of the bankrupt.

Opposition to a discharge can be made by a trustee only after he has been specifically authorized to do so at a meeting of creditors called for that purpose on the application of a creditor; or by direction of the referee. When the conduct of a case is in the hands of friends of the bankrupt, or of creditors whose financial interests have been conserved or when a case is a voluntary-involuntary self-conducted affair, it is difficult, if not impossible, to obtain a vote of a majority of the creditors to authorize the trustee to put in an opposition to a discharge. Indeed, practically all the creditors' claims, carrying with them their votes, may innocently have been assigned to creditors friendly to the bankrupt.

And thus the dishonest bankrupt is discharged and escapes even the slight punishment of being refused permission to reënter business and to have another opportunity to mulct honest traders.

Insufficient Criminal Provisions and Lack of Prosecution

Penalties prescribed in the law for dishonest practices were too mild and were too seldom invoked. This was a complaint that came from defrauded creditors and from government officials charged with enforcing the law.

The various loopholes through which flagrant offenders against the bankruptcy law have been able to escape punishment in past years, largely because of legal technicalities and lack of specific provisions in the bankruptcy act, were pointed to by business men as deliberate encouragements to dishonest debtors.

The provision that prosecution must be made within one year from the date of commission of an alleged offense was regarded as being too lenient. Offenders simply disappeared from a jurisdiction for a year, then returned, safe from prosecution.

Some of the offenses which dishonest debtors commit were so loosely defined in the law that it was difficult to convict.

Lack of prosecution of apparent offenders, due in part to indifference of creditors and in part to collusion between debtors and some of their creditors, was recognized as one of the weak spots of the system.

Unlawful Preferences

Preferences given some creditors over others, as a result of connivance between bankrupts and creditors, were recognized as one of the principal weaknesses of the bankruptcy procedure. The whole bankruptcy system is built on the idea of a thorough marshalling of assets and an equitable division among creditors.

When it becomes possible for one or more creditors to obtain more than a fair share of an estate, thus defrauding other creditors, and when it becomes possible for bankrupts to conceal and retain a part of their assets, sometimes by "taking care of" some creditors, the very purpose of the bankruptcy act is defeated.

Delays in Settling Estates

Delays in administering estates are caused largely by legal technicalities. They have been a source of irritation to business men, who hope for a prompt determination of issues involved and for a quick payment of dividends. Delays arise most often in cases in which large assets are found and have had to do chiefly with determination of titles to property and settlement of questions as to size, validity and priority of claims. In many cases trustees have had to resort to litigation in order to gain possession of all the assets of a bankrupt.

The length of time allowed for filing claims was likewise a cause for delay.

Miscellaneous Complaints

Treatment of some classes of claims as preferred, such as taxes on real estate only partly owned by a bankrupt, for all of which payment has been exacted from personal property in many cases, was a serious defect which operated to the disadvantage of the general creditors.

Assignment of claims on which petitions in involuntary bankruptcy were later filed was a practice of which complaint was heard frequently. It led in many cases to collusive petitions; it enabled persons to pose as creditors; it provided means whereby an undue control of the election of a trustee and of the handling of an estate might be gained for ulterior purposes.

Complaint was made that receivers and attorneys for receivers solicited claims against bankrupts and sought powers of attorney.

A serious complaint on the part of business men and credit men was that attorneys were permitted to hold and vote as many powers of attorney as they could obtain, while others than attorneys were not permitted to hold and vote more than a single power of attorney.

The official forms for use in transacting the business of a bankrupt estate and for administering the bankruptcy law are practically obsolete, and are often the subject of criticism.

CORRECTIVE MEASURES FOR CURE OF BANKRUPTCY ILLS

Amended Law, New Court Orders, Remedies Applied

THE principal corrective measures that are being applied to bankruptcy ills are, first the amendments to the national bankruptcy act, and second the new General Orders in Bankruptcy. The amendments made to the national bankruptcy act are printed in full in this letter-bulletin, beginning on this page; and the new General Orders in Bankruptcy are given in full on page 10.

Major Changes in Bankruptcy Act

The more important provisions of the amendatory act are those which

—*add new acts of bankruptcy, and strengthen the definitions of present acts of bankruptcy.*

—*make discharges from bankruptcy more difficult for dishonest bankrupts to obtain.*

—*limit discharges from bankruptcy to one in six years, whether voluntary or involuntary.*

—*increase from two to five years the possible term of imprisonment for various offenses against the bankruptcy act, including concealment of assets.*

—*add several new punishable offenses, such as*

(a) *Destruction or concealment of records.*

(b) *Concealment of property, by officer or agent of bankrupt.*

(c) *Concealment of property from receiver, as well as from trustee.*

(d) *Withholding of records from receiver or trustee.*

—*extend from one year to three the time in which prosecution of offenses may be made.*

—*make it obligatory for referees to report to United States attorneys all violations of the bankruptcy act that come to their notice.*

—*curtail the payment of certain taxes from estates.*

—*make provision for the payment of expenses of creditors who successfully oppose confirmation of compositions.*

—*prevent delays in adjudications and in settlement of estates caused by the offering of settlements in composition.*

—*make communications between creditors, and between creditors and referees and trustees, privileged, and not subject to action for slander or libel, if made in good faith.*

—*reduce time limit for proving claims from one year to six months after adjudication.*

—*give priority to payment of wages over payment of taxes, for first time in bankruptcy legislation.*

Minor Changes in Bankruptcy Act

The minor changes in the bankruptcy act which are made by the new law

—*define trusts as corporations, so far as their treatment in bankruptcy is concerned.*

—*define more carefully the territories to which the act applies.*

—*set the time for filing schedules of creditors, assets, and liabilities at ten days from date of filing petition, in voluntary bankruptcy cases.*

—*vest appellate jurisdiction in the Court of Appeals of the District of Columbia.*

—*make the limit of time for filing appeals from any court actions or rulings thirty days. It was ten days in some instances under the former law.*

—*include receivers and custodians (as well as trustees, as provided in former act) among those punishable for embezzlement from estates.*

—*raise the rates payable for stenographic and reporting services.*

—*make it possible for bankrupts to recover from the trustee their interests in patent and copyright applications.*

Amendments to National Bankruptcy Law

As Contained in S. 1039 To Take Effect August 27, 1926

NOTE: New matter is in Italic. Matter eliminated from former law is in brackets.

Title—"An Act to amend an act entitled, 'An act to establish a uniform system of bankruptcy throughout the United States', approved July 1, 1898, and acts amendatory thereof and supplementary thereto,"

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

That section 1 (a), subdivisions 6, 8, and 24 of an act entitled "An act to establish a uniform system of bankruptcy throughout the United States," approved July 1, 1898, and acts amendatory thereof and supplementary thereto, be, and the same hereby are, amended as follows:

"(6) 'Corporations' shall mean all bodies having any of the powers and privileges of private corporations not possessed by individuals or partnerships and shall include limited or other partnership associations organized under laws making the capital subscribed alone responsible for the debts of the association, *joint stock companies, unincorporated companies and associations, and any business conducted by a trustee, or trustees, wherein beneficial interest or ownership is evidenced by certificate or other written instrument.*

"(8) 'Courts of bankruptcy' shall include the district courts of the United States and of the Territories [including Porto Rico] *and possessions to which this Act is or may hereafter be applicable,* the Supreme

Court of the District of Columbia, and the United States Court [for the District] of Alaska.

"(24) States shall include the Territories [Alaska, Porto Rico,] *and possessions to which this Act is, or may hereafter be, applicable,* Alaska and the District of Columbia."

Sec. 2. That the introductory provision preceding subdivision 1 of section 2 of said Act, as so amended, be, and the same hereby is, amended to read as follows:

"*That* the courts of bankruptcy as hereinbefore defined, namely, the district courts of the United States in the several States, the Supreme Court of the District of Columbia, the district courts of the several Territories [including Porto Rico] *and possessions to which this Act is, or may hereafter be, applicable,* and the United States Court in the District of Alaska, are hereby made courts of bankruptcy, and are hereby invested, within their respective territorial limits as *now* established, or as they may be hereafter changed, with such jurisdiction at law and in equity as will enable them to exercise original jurisdiction in bankruptcy proceedings, in vacation in chambers and during their respective terms, as they are now or may be hereafter held."

Sec. 3. That section 3 (a) of said Act, as so amended, be, and the same hereby is, amended to read as follows:

"(a) Acts of bankruptcy by a person shall consist of his having (1) conveyed, transferred, concealed, or removed, or permitted to be concealed or removed, any part of his property with intent to hinder, delay, or defraud his creditors, or any of them; or (2) transferred, while insolvent, any portion of his property to one or more of his creditors with intent to prefer such creditors over his other creditors; or (3) suffered or permitted, while insolvent, any creditor to obtain a preference through legal proceedings, and not having at least five days before a sale or [final] *other* disposition of any property affected by such preference vacated or discharged such preference; or (4) *suffered, or permitted, while insolvent, any creditor to obtain through legal proceedings any levy, attachment, judgment, or other lien, and not having vacated or discharged the same within thirty days from the date such levy, attachment, judgment, or other lien was obtained;* or (5) made a general assignment for the benefit of his creditors; or, [being] *while* insolvent, [applied for] a receiver or *a* trustee [for his property or because of insolvency a receiver or trustee has been put in charge of his property under the laws of a state, of a territory, or of the United States,] has *been appointed, or put in charge of his property;* or (6) admitted in writing his inability to pay his debts and his willingness to be adjudged a bankrupt on that ground."

Sec. 4. That section 7 (a), subdivision (8), of said Act, as so amended, be, and the same hereby is, amended to read as follows:

"(8) Prepare, make oath to, and file in court within ten days [unless further time is granted], after [the] adjudication, if an involuntary bankrupt, and [with the petition] *within ten days after the filing of a petition,* if a voluntary bankrupt (*unless in either case further time is granted*), a schedule of his property showing the amount and kind of property, the location thereof, its money value in detail, and a list of his creditors showing their residence, if known; if unknown, that fact to be stated, the amounts due each of them, the consideration thereof, the security held by them, if any, and a claim for such exemptions, as he may be entitled to, all in triplicate, one copy of each for the clerk, one for the referee, and one for the trustee."

Sec. 5. That section 12 (a) of said Act, as so amended, be, and the same hereby is, amended to read as follows:

"(a) A bankrupt may offer, either before or after adjudication, terms of composition to his creditors, after, but not before, he has been examined in open court, or at a meeting of his creditors, and has filed in court the schedule of his property and the list of his creditors required to be filed by bankrupts. In compositions before adjudication the bankrupt shall file the required schedules, and thereupon the court shall call a meeting of creditors for the allowance of claims, examination of the bankrupt, and preservation or conduct of *the* estate[s], at which meeting the judge or referee shall preside; [and action upon the petition for adjudication shall be delayed until it shall be determined whether such composition shall be confirmed.] *but action upon the petition for adjudication shall not be delayed, except that the court, for good cause shown, may in its discretion delay such action upon such terms and conditions for the protection of and indemnity against loss by the bankrupt estate as may be proper.*"

Sec. 6. That section 14 (a) and (b) of said act, as so amended, be, and the same hereby is, amended to read as follows:

"(a) Any person may, after the expiration of one month and within [the next] twelve months, subsequent to being adjudged a bankrupt, file an application for a discharge in the court of bankruptcy in which the proceedings are pending; if it shall be made to appear to the judge that the bankrupt was unavoidably prevented from filing it within such time, it may be filed within but not after the expiration of the next six months.

"(b) The judge shall hear the application for a discharge and such proofs and pleas as may be made in opposition thereto by the trustee or other parties in interest, at such time as will give the trustee or parties in interest a reasonable opportunity to be fully heard; and investigate the merits of the application and discharge the applicant, unless he has (1) committed an offense punishable by imprisonment as herein provided; or (2) [with intent to conceal his financial condition] destroyed, [cancelled] *mutilated, falsified, concealed,* or failed to keep books of account, or records, from which [such] *his financial* condition *and business transactions* might be ascertained; *unless the court deem such failure or acts to have been justified, under all the circumstances of the case;* or (3) obtained money or property on credit, [upon a materially false statement in writing, made by him to any person or his representative for the purpose of obtaining credit from such person;] *or obtained an extension or renewal of credit, by making or publishing, or causing to be made or published, in any manner whatsoever, a materially false statement in writing respecting his financial condition;* or (4) at any time subsequent to the first day of the [four] *twelve* months immediately preceding the filing of the petition, [shall have] transferred, removed, destroyed, or concealed or permitted to be removed, destroyed, or concealed any of his property, with intent to hinder, delay, or defraud his creditors; or (5) [in voluntary proceedings] *has* been granted a discharge in bankruptcy within six years; or (6) in the course of [the] proceedings in bankruptcy, refused to obey any lawful order of or to answer any material question approved by the court; or (7) *has failed to explain satisfactorily any losses of assets or deficiency of assets to meet his liabilities: Provided, That if, upon the hearing of an objection to a discharge, the objector shall show to the satisfaction of the court that there are reasonable grounds for believing that the bankrupt has committed any of the acts which, under this paragraph (b), would prevent his discharge in bankruptcy, then the burden of proving that he has not committed any of such acts shall be upon the bankrupt:* And provided *further,* That the trustee shall not interpose objections to a bankrupt's discharge until he shall be authorized so to do *by the creditors* at a meeting of creditors called for that purpose *on the application of any creditor.*"

Sec. 7. That section 21 of said act, as so amended, be, and the same hereby is, amended by adding after paragraph (g) thereof a new paragraph (h), to read as follows:

"*(h) A communication by a creditor, receiver, or trustee of one by or against whom a bankruptcy petition is filed, or who has been adjudicated a bankrupt, to another creditor, uttered in good faith and with reasonable grounds for belief in its truth, concerning the conduct, acts, or property of such bankrupt, shall be privileged, and the creditor, receiver, or trustee so uttering the same shall not be held liable therefor.*"

Sec. 8. That section 23 of said Act, as so amended, be, and the same hereby is, amended to read as follows:

"(a) The United States [circuit] *district* courts shall have jurisdiction of all controversies at law and in equity, as distinguished from proceedings in bankruptcy, between trustees as such and adverse claimants concerning the property acquired or claimed by the trustees, in the same manner and to the same extent only as though bankruptcy proceedings had not been instituted and such controversies had been between the bankrupts and such adverse claimants.

"(b) Suits by the trustee shall [only] be brought or prosecuted *only* in the courts where the bankrupt, whose estate is being administered by such trustee, might have brought or prosecuted them if proceedings in bankruptcy had not been instituted, unless by consent of the proposed defendant, except suits for the recovery of property under section [62] *60,* subdivision b; section [69] *67,* subdivision e; and section [72] *70,* subdivision e."

Sec. 9. That section 24 (a) and (b) of said Act, as so amended, be, and the same hereby is, amended to read as follows, and by adding at the end thereof, a new subdivision (c), to read as follows:

"(a) The Supreme Court of the United States, the circuit courts of appeal[s] of the United States, *the Court of Appeals of the District of Columbia,* and the supreme courts of the Territories, in vacation, in chambers and during their respective terms, as now or as they may be hereafter held, are hereby invested with appellate jurisdiction of controversies arising in bankruptcy proceedings from the courts of bankruptcy from which they have appellate jurisdiction in other cases. [The Supreme Court of the United States shall exercise a like jurisdiction from courts of bankruptcy not within any organized circuit of the United States and from the Supreme Court of the District of Columbia.]

"(b) The several circuit courts of appeal *and the Court of Appeals of the District of Columbia* shall have jurisdiction in equity, either interlocutory or final, to superintend and revise in matter of law (*and in matter of law and fact the matters specified in section 25*) the proceedings of the several inferior courts of bankruptcy within their jurisdiction. Such power shall be exercised [on due notice and petition by any

party aggrieved.] *by appeal and in the form and manner of an appeal, except in the cases mentioned in said section 25 to be allowed in the discretion of the appellate court.*

"(c) *All appeals under this section shall be taken within thirty days after the judgment, or order, or other matter complained of, has been rendered or entered.*"

Sec. 10. That section 25 (a) of said Act, as so amended, be, and the same is, amended to read as follows:

"(a) *That* appeals, as in equity cases, may be taken in bankruptcy proceedings from the courts of bankruptcy to the circuit courts of appeal[s] of the United States *and the Court of Appeals of the District of Columbia* and to the supreme courts of the Territories in the following cases, to wit: (1) From a judgment adjudging or refusing to adjudge the defendant a bankrupt; (2) from a judgment granting or denying a discharge; and (3) from a judgment allowing or rejecting a debt or claim of $500 or over. Such appeal shall be taken within [ten] *thirty* days after the judgment appealed from has been rendered, and may be heard and determined by the appellate court in term or vacation, as the case may be."

Sec. 11. That section 29 (a), (b), and (d) of said Act, as so amended, be, and the same hereby is, amended to read as follows, and that section 29 be further amended by adding after paragraph (d) thereof a new paragraph (e) to read as follows:

"(a) A person shall be punished by imprisonment for a period *of* not to exceed five years upon conviction of the offense of having knowingly and fraudulently appropriated to his own use, embezzled, spent, or unlawfully transferred any property or secreted or destroyed any document belonging to a bankrupt estate which came into his charge as trustee, *receiver, custodian, or other officer of the court.*

"(b) A person shall be punished by imprisonment for a period *of* not to exceed [two] *five* years upon conviction of the offense of having knowingly and fraudulently (1) concealed [while a bankrupt or after his discharge] from [his] *the receiver,* trustee, *United States marshal, or other officer of the court charged with the control or custody of property, or from creditors in composition cases,* any [of the] property belonging to [his estate in bankruptcy.] *the estate of a bankrupt;* or (2) made a false oath or account in, or in relation to any proceeding in bankruptcy; or (3) presented under oath any false claim for proof against the estate of a bankrupt, or used any such claim in composition, personally, or by agent, proxy, or attorney, or as agent, proxy, or attorney; or (4) received any material amount of property from a bankrupt after the filing of the petition with intent to defeat this act; or (5) [extorted or attempted to extort] *received or attempted to obtain* any money or property, *remuneration, compensation, reward, advantage, or promise thereof* from any person, [as a consideration] for acting or forbearing to act in bankruptcy proceedings; or (6) *having been an officer or agent of any person or corporation, and in contemplation of the bankruptcy of such person or corporation, or with intent to defeat the operation of this act, concealed or transferred any of the property of the debtor; or (7) after the filing of the petition, or, in contemplation of bankruptcy, concealed, destroyed, mutilated, or falsified any book, document, or record affecting or relating to the property or affairs of a bankrupt; or (8) after the filing of the petition, withheld from the receiver or trustee any book, document, or paper affecting or relating to the property or affairs of a bankrupt, to the possession of which he is entitled.*

"(d) A person shall not be prosecuted for any offense arising under this act unless the indictment is found or the information is filed in court within [one] *three* years after the commission of the offense.

"(e) *(1) Whenever any referee, receiver, or trustee shall have grounds for believing that any offense under this act has been committed, or from facts or circumstances brought out in the course of administration or otherwise brought to his attention, that there is reasonable ground to believe that such an offense has been committed, or for special reason, an investigation should be had in connection therewith, it shall be the duty of such referee, receiver, or trustee to report such matter to the United States attorney for the district in which it is believed such an offense has been committed, including in such report a statement of all the facts and circumstances of the case within his knowledge, with the names of the witnesses, and a statement as to the offense or offenses believed to have been committed.*

"(2) *It shall be the duty of every United States attorney immediately to inquire into the fact so reported to him by any referee, receiver, or trustee, and the law applicable thereto, and if it appears probable that any offense under this act has been committed, in a proper case and without delay, to present the matter to the grand jury, unless upon inquiry and examination such district attorney decides that the ends of public justice do not require that the alleged offense should be investigated or prosecuted, in which case he shall report the facts to the Attorney General for his direction in the premises.*"

Sec. 12. That section 38 (a), subdivision 5, of said act, as so amended, be, and the same hereby is, amended to read as follows:

"(5) [And, upon the application of the trustee] During the examination of the bankrupt[s], or other proceedings, authorize the employment of stenographers [at the expense of the estates at a compensation not to exceed ten cents per folio] for reporting and transcribing the proceedings *at such reasonable expense to the estate as the court may fix.*"

Sec. 13. That section 57 (n), of said act, as so amended, be, and the same hereby is, amended to read as follows:

"(n) Claims shall not be proved against a bankrupt estate subsequent to [one year] *six months* after the adjudication; or if they are liquidated by litigation and the final judgment therein is rendered within 30 days before or after the expiration of such time, then within 60 days after the rendition of such judgment: Provided, That the right of infants and insane persons without guardians, without notice of the proceedings, may continue six months longer."

Sec. 14. That section 60 (a), of said act as so amended, be, and the same hereby is, amended to read as follows:

"(a) A person shall be deemed to have given a preference if, being insolvent, he has, within four months before the filing of the petition, or after the filing of the petition and before the adjudication, procured or suffered a judgment to be entered against himself in favor of any person, or made a transfer of any of his property, and the effect of the enforcement of such judgment or transfer will be to enable any one of his creditors to obtain a greater percentage of his debt than any other of such creditors of the same class. Where the preference consists in a transfer, such period of four months shall not expire until four months after the date of [the] recording or registering of the transfer, if by law such recording or registering is required *or permitted.*"

Sec. 15. That section 64, subdivisions (a) and (b), of said act, as so amended, be, and the same hereby are, amended to read as follows:

"(a) The court shall order the trustee to pay all taxes legally due and owing by the bankrupt to the United States, State, county, district, or municipality, in [advance of the payment of dividends to creditors] *the order of priority as set forth in paragraph (b) hereof: Provided, That no order shall be made for the payment of a tax assessed against real estate of a bankrupt in excess of the value of the interest of the bankrupt estate therein as determined by the court.* Upon filing the receipts of the proper public officers for such payments [he] *the trustee* shall be credited with the amounts thereof, and in case any question arises as to the amount or legality of any such tax the same shall be heard and determined by the court.

"(b) The debts to have priority, [except as herein provided] *in advance of the payment of dividends to creditors,* and to be paid in full out of bankrupt estates, and the order of payment shall be (1) the actual and necessary cost of preserving the estate subsequent to filing the petition; (2) the filing fees paid by creditors in involuntary cases, and, where property of the bankrupt, transferred or concealed by him either before or after the filing of the petition, shall have been recovered for the benefit of the estate of the bankrupt by the efforts and at the expense of one or more creditors, the reasonable expense[s] of such recovery; (3) the cost of administration, including the fees and mileage payable to witnesses as *now or hereafter* provided [or to be provided] by the laws of the United States, and one reasonable attorney's fee, for the professional services actually rendered, irrespective of the number of attorneys employed, to the petitioning creditors in involuntary cases *while performing the duties herein prescribed, and* to the bankrupt *in voluntary and* involuntary cases, as the court may allow; (4) *where the confirmation of composition terms has been refused or set aside upon the objection and through the efforts and at the expense of one or more creditors, in the discretion of the court, the reasonable expenses of such creditors in opposing such composition;* (5) wages due to workmen, clerks, traveling or city salesmen, or servants, which have been earned within three months before the date of the commencement of *the* proceeding[s], not to exceed [$300] *$600* to each claimant; (6) *taxes payable under paragraph (a) hereof and* (7) debts owing to any person who by the laws of the States or the United States is entitled to priority: *Provided, That the term 'person' as used in this section shall include corporations, the United States and the several States and Territories of the United States.*"

Sec. 16. That section 70, subdivision (a) 2, of said act as so amended, be, and the same hereby is, amended to read as follows:

"(2) Interests in patents, patent rights, copyrights, and trademarks, *and in applications for patents, copyrights, and trade-marks: Provided, That in case the trustee, within thirty days after appointment, does not notify the applicant for a patent, copyright, or trade-mark of his election to prosecute the application to allowance or rejection, the bankrupt may apply to the court for an order revesting him with the title thereto, which petition shall be granted, unless, for cause shown by the trustee, the court grants further time to the trustee for making such selection; and such applicant may, in any event, at any time petition the court to be revested with such*

title in case the trustee shall fail to prosecute such application with reasonable diligence; and the court, upon revesting the bankrupt with such title, shall direct the trustee to execute proper instruments of transfer to make the same effective in law and upon the records."

Sec. 17. Nothing herein contained shall have the effect to release or extinguish any penalty, forfeiture, or liability incurred under any act or acts of which this act is amendatory.

Sec. 18. The provisions of this amendatory act shall govern proceedings, so far as practicable and applicable, in bankruptcy cases pending when it takes effect; but as to proceedings in cases pending when this act takes effect, to which the provisions of this amendatory act are not applicable, such proceedings shall be disposed of conformably to the provisions of said act approved July 1, 1898, and the acts amendatory thereof and supplementary thereto.

Sec. 19. All acts or parts of acts inconsistent with any provisions of this act are hereby repealed.

Sec. 20. This act shall take effect and be in force on and after three months from the date of its approval.

New General Orders in Bankruptcy

THE new General Orders in Bankruptcy, promulgated by the United States Supreme Court April 13, 1925, consist of one amendment to General Order No. 5 and of seven additional rules. They are:

General order number 5, of those promulgated by the Supreme Court, entitled "Frame of Petition" is amended by adding to the end thereof: Petitioners in involuntary proceedings whose claims rest upon assignment or transfer from other persons, shall annex to one of the duplicate petitions all instruments of assignment or transfer, and an affidavit setting forth the true consideration paid for the assignment or transfer of such claims and stating that the petitioners are the bone fide holders and legal beneficial owners thereof and whether or not they were purchased for the purpose of instituting bankruptcy proceedings.

The following rules are added as general orders in bankruptcy:

XXXIX

Representation of Creditors by Receivers or Their Attorneys

Neither a receiver nor his attorney shall solicit any proof of debt, power of attorney, or other authority to act for, or represent, any creditor for any purpose in connection with the administration of the estate in bankruptcy or the acceptance or rejection of any composition offered by a bankrupt.

XL

Receivers and Marshalls as Custodians

A receiver or marshall appointed by the court to take charge of the property of a bankrupt after the filing of a petition, shall be deemed to be a mere custodian within the meaning of section 48 of the bankruptcy act, unless his duties and compensation are specifically enlarged by order of the court, upon proper cause shown, either at the time of the appointment or later.

XLI

Waiver of Right to Share in Composition Deposits

Before confirming a composition the judge of the court shall require all creditors and other persons who may have waived their right to share in the distribution of the deposit made by the bankrupt, for claims, fees or otherwise, to set forth in writing and under oath all agreements with respect thereto with the bankrupt, his attorney or any other person, and shall also require an affidavit by the bankrupt that he has not directly or indirectly paid or promised any consideration to any attorney, trustee, receiver, creditor, or other person in connection with the composition proceedings except as set forth in such affidavits or the offer of composition, and that he has no knowledge of any such payment or promise by other party.

XLII

Compensation of Attorneys, Receivers and Trustees

1. Every attorney, receiver and trustee seeking an allowance of compensation from a bankrupt estate for services rendered, shall file with the referee a petition under oath, setting forth a full and detailed statement of such services and the amount claimed therefor, and, in the case of an attorney or receiver, the amount of the partial allowance, if any, theretofore made. And such petition shall be accompanied by an affidavit of the applicant stating that no agreement has been made, directly or indirectly, and that no understanding exists, for a division of fees between the applicant and the receiver, the trustee, the bankrupt, or the attorney of any of them. In the absence of such petition and affidavit no allowance of compensation shall be made.

2. Such petition shall be heard at a meeting of creditors; and the referee in sending the notice of such meeting prescribed by section 58 of the bankruptcy act, shall state by whom and in what amount the allowance of the compensation is asked.

XLIII

Fees and Expenses of Attorneys for Petitioning Creditors

The court may deny the allowance of any fee to the attorney for petitioning creditors or the reimbursement of his expenses, or both, if it shall appear that the proceedings were instituted in collusion with the bankrupt or were not instituted in good faith.

XLIV

Appointment of Attorneys for Receivers or Trustees

In any district in which there is a city having at the last federal census a population of 250,000 or more, no attorney for a receiver or a trustee shall be appointed except upon the order of the court, which shall be granted only upon the petition of the receiver or trustee, stating the name of the counsel whom he wishes to employ, the reasons for his selection, and the necessity for employing counsel at all; and there shall be submitted with this petition an affidavit of the person recommended, showing that he is not employed or connected with the bankrupt or any person having an interest adverse to the receiver, trustee or creditors.

XLV

Auctioneers, Accountants and Appraisers

No auctioneer or accountant shall be employed by a receiver or trustee except upon an order of the court expressly fixing the amount of the compensation or the rate or measure thereof. The compensation of appraisers shall be provided for in like manner in the order appointing them.

ANALYSIS OF NEW GENERAL ORDERS AND OF AMENDMENTS TO LAW

Strict Practices Set Up By New Regulations and By Strengthened Statute

EACH of the corrective measures presented in the preceding section is aimed at some particular weakness of the bankruptcy system. An understanding of the probable effect of these corrective measures is of value not only to practising accountants, but to the business public, bankers, credit men and attorneys as well. A brief analysis of the reasons for the promulgation of the new General Orders and for the changes made in the law will be given here.

The new General Orders in Bankruptcy are intended to prevent

—*assignment of claims by creditors to other creditors or to attorneys except for a real consideration (order V);*
—*solicitation of claims by receivers or their attorneys (order XXXIX);*
—*incurring of excessive fees for receivers (order XL);*
—*private agreements relative to compositions in which some creditors have waived participation (order XLI);*
—*excessive fees of attorneys and trustees (order XLII);*
—*"splitting" of fees (order XLII);*
—*granting of allowances from estates without notice to creditors (order XLII);*
—*payment of attorney's fees in cases in which collusion appears (order XLIII);*
—*multiplicity of counsel (order XLIV);*
—*employment by receivers or trustees of attorneys employed by or connected with the bankrupt (order XLIV);*
—*indeterminate fees for auctioneers, accountants and appraisers (order XLV).*

Changes in Bankruptcy Act

Mr. Fleischmann, chairman of the Special Committee on Practice in Bankruptcy of the American Bar Association, which coöperated with the Commercial Law League of America and with the National Association of Credit Men in drafting the amendments to the national bankruptcy act, prepared a statement relative to these amendments, for the information of the Committee on the Judiciary of the House of Representatives. Excerpts from Mr. Fleischmann's statement will be quoted here in analyzing the changes made in the national bankruptcy act.

Acts of Bankruptcy

Section 3 (a) (4) is a new provision. The reason for this new clause as formulated by the Senate Judiciary Committee is as follows:

> "This amendment is for the purpose of preventing a creditor from obtaining a lien and holding it without proceeding to sale under it until it ripens into a preference, as it was held it might, in Citizens Banking Co. v. Revenna National Bank (234 U. S. 360)."

Discussing Section 3 (a) (4) (made subdivision [5] in amended bill), Mr. Fleischmann said:

> "This subdivision of the bankruptcy act defines acts of bankruptcy, and as it reads in the present law includes as one of such acts the making of 'a general assignment for the benefit of his creditors, or, being insolvent, applied for a receiver or trustee for his property, or because of insolvency, a receiver or trustee has been in charge of his property under the laws of a state, or a territory, of the United States.' The amendment substitutes for the above language the words, 'made a general assignment for the benefit of his creditors; or, while insolvent, a receiver or trustee has been appointed or put in charge of his property.'
>
> "This amendment is intended to prevent an evasion of the bankruptcy act by a departure in the method of appointment of a receiver or trustee, or by other subterfuges, which, it is believed, the more comprehensive substituted phrase will thwart."

Proponents of this clause said that too often receivers were appointed and lingered along for years, when there should have been a bankruptcy adjudication and a trustee.

Composition Offer Will Not Stay Proceedings

> Mr. Fleischmann: "Section 12 (a): This section of the bankruptcy act, as it now stands, provides that where a bankrupt offers a composition either before or after adjudication, action upon the petition for adjudication shall automatically be delayed until it shall be determined whether such composition shall be so confirmed.
>
> "Unreasonable delays, intermediate disappearance or dissipation of assets, and other glaring abuses have arisen from this definite stay of proceedings.
>
> "The amendment continues to authorize offers of composition, either before or after adjudication, but provides that action upon the petition for adjudication shall not be stayed except that the court, for good cause shown, and upon proper terms, protecting the estate against loss, may, in its discretion delay such action."

Discharges From Bankruptcy

The section of the present law defining the conditions under which discharges may be refused by the courts is materially strengthened by the proposed amendments. Four of the existing clauses are reworded so as to cope with the activities of fraudulent bankrupts, and two new clauses are added.

Discussing section 14 (b) subdivision (2) Mr. Fleischmann said:

> "The law as it now stands when compared with bankruptcy systems of other countries on the one hand, and practical human considerations on the other, is believed to be and has been criticized as too broad in some respects and too narrow in others. It does not for instance allow any explanation or justification for the mere failure to keep books of account, although in some cases mitigating circumstances may exist which should not deprive an honest debtor of his discharge on that score.

"The amendment is intended to make the provision reasonable and capable of just application by the court, under all the circumstances of a given case. . . ."

False Financial Statements

The wording of subdivision (b) (3) of section 14 is strengthened by inserting a proviso against obtaining an extension of credit through use of a false financial statement. It will be noted that the new wording also strengthens the provisions as to the use made of a materially false statement. Discussing this section Mr. Fleischmann said:

"Under this provision, as it stood, a discharge could not be denied where the debtor promulgated materially false statements as to his financial condition through commercial and trade agencies which distribute the information therein contained; and although creditors may have given credit on the strength of such statements, which come to their attention, they were not a ground for refusing a discharge where they were not given to a person for the purpose of obtaining credit 'from such person.'

"Section 14 (b) (5): The bankruptcy act prohibited a discharge where there had been a prior discharge within six years, but is limited to voluntary proceedings. It is well known that involuntary proceedings are often instigated by a bankrupt himself to avoid the limitation and to enable him to enjoy a chronic series of bankruptcies at comparatively brief intervals. The amendment omits the words 'in voluntary proceedings,' and leaves the obstacle no more than one discharge in six years applicable alike to voluntary and to involuntary proceedings.

Burden of Proof on Bankrupt

"Section 14 (b) (7): This is a new provision which adds, as a further ground of objection to a discharge, the failure of a debtor to account satisfactorily for losses or deficiencies of assets to meet his liabilities.

"The amendment, however, further provides that where the objector shows that there is reason for belief that the bankrupt has committed any of the acts under section 14-b, which would prevent his discharge, the burden of proving that he has not committed the same shall be upon the bankrupt.

Creditors' Communications Privileged

"Section 21 (h): This is a new provision, making communications between creditors, receivers, and trustees, concerning the acts or property of bankrupts, privileged, and relieving those uttering the same from liability therefor, where such communications have been made in good faith. This provision is deemed desirable to afford larger means of investigation of bankrupt's assets, liabilities, and general conduct in connection with his bankruptcy or discharge."

Strengthening Criminal Provisions— Providing for Prosecutions

The important task of tightening the criminal provisions of the law, and of providing for prompt and effective prosecution of alleged offenders is accomplished by amendments to the law by which penalties are increased, offenses more carefully defined, additional offenses enumerated, and provision made for the prosecution of bankrupts and others who the evidence shows have violated any part of the act.

The period of possible imprisonment is increased to five years, for a series of eight specified acts, from a maximum of two years imprisonment for committing any one of five acts named in the law before amendment. These changes are in section (29) (a) (b) and (d).

Mr. Fleischmann: "Section 29 (a): This subdivision of the bankruptcy act makes it a crime to misappropriate property or to destroy documents coming into the hands of the trustee. The amendment extends the provision to a receiver, custodian, or other officer of the court, the omission of whom, in the original act, probably was inadvertent.

"Section 29 (b) (1): This subdivision of the bankruptcy act makes it a crime . . . , to conceal property from a trustee, and has been judicially construed to apply only to a concealment by the bankrupt or his agent. (Kauffman v. U. S. 212 Fed. 613; Good v. Kane, 211 Fed. 256.) The amendment includes a receiver or trustee for the reasons stated in connection with the above amendment to section 29 (a), and extends the provisions to persons other than the bankrupt who may be guilty of such concealment."

Harold Remington of New York, an attorney, discussing this point before the Committee on Judiciary of the House of Representatives made it clear that the district attorneys of the country wanted a law that is definite. They said, he reported, that it would not do to say that a culprit had simply concealed assets. One must say that he has concealed assets from somebody.

New Offenses Defined

Mr. Fleischmann: "Section 29 (b) (5), (6), (7) and (8): These subdivisions, [with the exception of (5)], are new and are intended to extend the list and definitions of criminal acts of which a bankrupt may be guilty to cases and situations therein explained, the existing subdivision having been found, by experience, to be inadequate to meet the specific offenses to be enumerated by these amendatory additions.

"Section 29 (d): This subdivision of the bankruptcy act fixed a one-year statute of limitations for prosecution for the offenses therein enumerated. The amendment extends this period to three years. It is a common experience that fraudulent bankrupts depart from the jurisdiction for a year and then return having secured immunity from prosecution. This amendment has the approval of various United States attorneys general, and also conforms with the federal statute of limitation applicable to similar offenses.

Prosecutions Assured

"Section 29 (e) [subdivisions (1) and (2)]: This is a new subdivision intended to promote the enforcement of criminal restraints on dishonest methods in bankruptcy proceedings. It directs receivers and trustees to report to the United States attorney, with the approval of the court, circumstances affording ground to believe that offenses have been committed, and the United States Attorney shall examine into the case and lay it before the grand jury."

Tax Payments From Estates Limited

Mr. Fleischmann: "Section 64 (a): This subdivision of the bankruptcy act provides for the payment by the trustee of taxes owing by the bankrupt in advance of the payment of dividends to creditors.

"The amendment . . . eliminates the phrase 'in advance of payment to creditors,' but restores it in subdivision (b), which provides for priorities.

"The amendment of this subdivision further provides that no taxes assessed against real estate of the bankrupt shall be paid in excess of the value of the interest of the bankrupt estate therein, nor upon property of the bankrupt exempt from sale under execution.

"The reasons for this latter amendment are that, at present, estates may be and are depleted, and, at times, consumed by the payment of taxes upon property in which the bankrupt has only a limited interest, with the result that the only beneficiaries in such a situation are mortgagees or other lienors, to the exclusion of creditors, who should not be required to contribute to the payment of taxes upon property, or interest in property, which is not applicable to the liquidation of their claims.

Encouraging Investigation of Compositions

"Section 64 (b) (4): This is a new subdivision, which provides that where confirmation of a composition has been refused, or set aside upon objection, and at the expense of one or more creditors, the expenses of such creditors in opposing such composition shall be paid out of the bankrupt estate.

"The reason for this amendment is that under the bankruptcy act as it stands the expenses of creditors in recovering property of the bankrupt for the estate, transferred or concealed, are entitled to priority in payment, but no provision is made for the payment of expenses of creditors, who, through their own efforts, defeat the confirmation of a dishonest composition, although the estate is equally benefited by such a procedure. The result of this omission is to discourage opposition to dishonest compositions. It is believed that the allowance of such expenses will deter bankrupts from risking the making of fraudulent compositions, which have become well founded grounds for complaint.

Wages to be Paid Before Taxes

"Section 64 (b) (6): This is a new subdivision. The bankruptcy act did not provide for the order of priority in which taxes, owing by the bankrupt estate, should be paid, or, at least, there was doubt as to what priority they were entitled to have. The amendment fixes a definite priority in the payment of such taxes, subordinate to other items of expenditure."

For the first time in the history of American bankruptcy, payment of wages is placed, in the amended law, in a position of priority over taxes.

The contention was made by representatives of organized labor before the Congressional Committee that wages should be placed ahead of everything else in the order of priority, and that there should be no limit on the amount of accumulated wages that could be paid, nor as to the time in which the wages were earned. The committee set the limit at $600, and pointed out that the limitation as to the period in which wages are earned is absolutely necessary as a preventive measure against collusion between debtors and others, who might present fictitious claims for large sums, dating back for years, and thus mulct an estate. The committee felt, too, that the cost of assembling, preserving and administering estates, including the fees of officers and of attorneys, should have priority over wages.

Minor Proposed Changes

Analysis of some of the less important changes made by the amendatory act follows:

Common-Law Trusts

Mr. Fleischmann: "Section 1 (a) (6): This subdivision of the present bankruptcy act defined 'corporations' . . . The amendment adds to this definition unincorporated companies and associations and common-law trusts.

"There is at present doubt or uncertainty under judicial construction whether the existing definition of corporations includes unincorporated companies, associations and common-law trusts used more and more in commercial activities of the nation, which should be removed, as it is by the . . . amendment.

"Section 38 (a) (5): This subdivision of the bankruptcy act limited the compensation of stenographers to 10 cents per folio for reporting and transcribing proceedings. The amendment eliminates the rate of compensation and permits the court to fix the reasonable expense of stenographic service. It has been found that, in larger cities, competent stenographers cannot be secured at the lower rates now prescribed. The amendment conforms with the recommendation of the Federal judges.

Attorney's Fees

"Section 64 (b) (3): This subdivision of the bankruptcy act provides for one reasonable attorney's fee to petitioning creditors in involuntary cases and to the bankrupt in involuntary cases, while performing the duties therein prescribed, and to the bankrupt in voluntary cases, as the court may allow. The amendment modifies the phraseology of this provision, and includes such an allowance to the bankrupt in involuntary as well as voluntary cases.

Disposal of Applications for Patents

"Section 70 (a) (2): This subdivision of the bankruptcy act provided that the estate of the bankrupt, with which the trustee becomes vested, includes, among other things, his interest in patents, patent rights, copyrights, and trademarks. The amendment adds to these, pending applications for patents, with provisions for the proper protection of the bankrupt, and of the trustee, dependent upon the trustee's election to prosecute or reject the application.

"The reasons for this amendment are that there appears to be no valid ground for excluding an application for a patent from the assets of a bankrupt estate where a patent, itself, is not excluded. Besides, there appears to be doubt as to the state of the law as to how such an application is to be treated under the bankruptcy law, as it stands, which doubt the amendment is intended to clear up: (See In re McDonnell, 111 Fed. 239; In re Dann, 129 Fed. 495; Ingle v. Landis Co., 262 Fed. 150; Canelo v. Mfg. Co., 185 Fed. 276, and other authorities.)

When Act Takes Effect

"(Section 18 of the amendatory bill): This section provides that the amendatory act shall govern proceedings, so far as practicable and applicable, in bankruptcy cases which are pending when it takes effect; but as to proceedings in pending cases when the act takes effect, to which its provisions are not applicable, such proceedings shall be disposed of in accordance with the provisions of the original bankruptcy act.

"The reasons for this provision are that the bankruptcy act is essentially a practice act, and the amendatory provisions in most cases can be applied to incidental proceedings, in pending cases, with beneficial results to creditors in whose interest the amendatory act is essentially proposed."

The Official Receiver Plan—Not Included in New Law

THE most important and far reaching proposed amendment which is not included in the new law is that providing for official salaried receivers, and possibly salaried referees, with the elimination of the trustee from a majority of cases.

The official receiver plan, in brief, is that in districts including a city of 500,000 population or more the district judges may, if they wish, sitting as a board, vote to name official receivers for their districts. One measure—the Fairchild bill—sets the salaries of official receivers at $10,000 a year, places the referees on salary at $12,000 a year, and provides for an official auditor at $7,500, all of them to have additional allowances for office staffs. Fees of receivers and referees allowed in the present law would be turned over to the United States Treasury.

The official receivers would be the first to act in all cases, taking charge of estates, large and small, and when a meeting of creditors was held, the creditors in cases with assets above $10,000 could decide for themselves whether to continue the administration of the official receiver or to elect a trustee. In cases with assets below $10,000 the official receiver would continue automatically to serve, and no trustee would be elected. In all cases the official receiver would supervise the administration of estates, even though the creditors elected a trustee. It would be the duty of the official receiver to examine the bankrupt privately, in every case. A public examination before the creditors would follow.

One of the most important provisions of the Fairchild bill providing for an official receiver system is that calling for the appointment of an official auditor. J. Noble Hays, of the Merchants Association of New York, reported to the Committee on Judiciary of the House of Representatives that there was not a dissenting voice in regard to that provision anywhere.

The proposed functions of the official auditor as described in the measure introduced by Representative Fairchild would be:

> "It shall be the duty of such auditor to obtain the necessary information and prepare statistics of the numbers of cases during each year of voluntary and involuntary bankruptcies within such circuit, classification of the occupation of bankrupts, the amount of the property of the estates, the dividends paid, and the expenses of administering such estates, and to report the same to the Attorney General of the United States, and it shall also be the duty of said auditor to supervise the proceedings and expenditures of receivers and referees in said circuit and to report the same to the circuit judge under the rules to be made by him. It shall also be the duty of said auditor upon the request of any district judge to make an examination of the conduct and proceedings of bankrupts for the purpose of ascertaining whether there is sufficient ground for the institution of civil proceedings to recover assets which have been fraudulently concealed or disposed of, or for the purpose of placing information before the United States Attorney for criminal prosecution."

Opinion on the official receiver plan does not seem to be well formed. Little appears to be known of it in other cities than New York and Chicago. Apparently no very serious objections to it have been raised, and on the other hand little sentiment in its favor has been aroused in Congress.

Arguments for Plan

Some of the arguments advanced in behalf of the official receiver plan are:

1—It would insure efficient and economical investigation and handling of the small cases, constituting 85 per cent of the bankruptcies. It is from these small cases that most criticisms come relative to the bankruptcy system.
2—It would relieve the judges of the necessity of choosing a receiver for each case.
3—The difficulty of obtaining competent, qualified men to serve in small cases would be overcome.
4—An official receiver could prevent many of the losses that are sustained by estates before the trustees are elected.
5—Creditor control of estates is taken away only in the small cases, in which creditors usually show little interest under the present system.
6—The unnecessarily large costs of administering small estates would be reduced, by the elimination of trustees' fees, and of fees for attorneys for trustees.
7—The official receivers, referees and auditors would become ministerial officers of the court. Bankruptcy courts operate under a great handicap because they must attempt to execute their own judgments, whereas other courts have their officers who execute their judgments.
8—Every one of the Federal judges in the City of New York, according to J. Noble Hays, has said that he believes the official receiver plan would be a good thing for the courts and that he would like to see the system instituted.
9—Official auditors are needed to prepare reliable statistics relative to bankruptcy matters.
10—New York now has official liquidators in the insurance department, and in the banking department, who have effected great savings in administrative expense.
11—The official receiver system means a single administration, instead of a dual administration first by a receiver and then by a trustee, (the present system).

Arguments in Opposition

Some of the arguments made in opposition are:

1—Expenses would be increased because salaries of official referees in some cities would be larger than their earnings under present fee system.
2—A receiver appointed at the request of creditors will take a greater interest in a case than an official receiver and will marshall more assets than a receiver who is not especially interested in the estate.
3—Proposed salaries for official receivers and referees are larger than those of the judges who appoint them.
4—The democratic feature of the law, which permits creditors, through a trustee, to take over and manage the affairs of the bankrupt, would be eliminated in a majority of cases.

Various national organizations which studied the need for bankruptcy reforms stated definitely that they did not wish the amendatory measure to include provisions calling for official receivers and salaried referees. They expressed the fear that the inclusion of such provisions in that bill might result in the defeat of the entire measure in Congress. They made the suggestion that if there is sufficient sentiment for official receivers and salaried referees, such provisions be included in a separate bill. That suggestion was adopted. No action has been taken by Congress on the separate bill.

The Accomplishments of the Credit Protection Fund of the National Association of Credit Men

Written for this Letter-Bulletin by J. H. Tregoe, Executive Manager, National Association of Credit Men

BRINGING the credit coyote to justice is not an innovation for the National Association of Credit Men despite the fact that this organization of about 30,000 credit executives recently raised a fund of $1,000,000 for the express purpose of investigating bankruptcy and other credit frauds. However, the credit protection work of the association is new in the sense that it is now conducted on a vast scale. Heretofore the work was done under the direction of a chief investigator in New York. Today there are three divisional offices and before many months there will be more than 20 local bureaus in operation.

At the time this is being written the Credit Protection Fund is being increased by about a half million dollars, so that the entire national membership of the association will have been reached for subscriptions.

The fund was raised to drive out the master crooks and in the process deter others from criminal fraud by a demonstration of efficiency. The theory has been put into practice and has worked. One marked indication of the success of the plan has been an increased number of friendly settlements through the association. Heretofore, men who would have resorted to crime in an attempt to stave off failure or bankruptcy, now are glad to place themselves in the hands of the association and thus preserve a clear record so that their estates can be equitably settled. It frequently happens in these adjustments, which are conducted by the association's Adjustment Bureaus, that honest debtors are put once again on their feet or else businesses are wound up to the greatest advantage of their creditors and to themselves.

What Cases Are Prosecuted

Before the fund was put into effective operation a few common sense rules based on sound legal practice were found necessary. There had to be limits to the activity of the Credit Protection Department to obviate a scattered fire in various sorts of criminal fraud which were of greater concern to other business men than to the credit manager. At present before a case is considered preparatory to presenting it to a case committee of the association three principal factors must be determined:

1. Is there an apparent violation of the Federal statutes covering concealment of assets from a trustee in bankruptcy and the use of the mails in a scheme to defraud; and violation of state statutes covering the issuance of a false financial statement or obtaining goods under false pretences?

2. If the credit protection department becomes convinced of one of the above, it must be further convinced that there is a reasonable indication that criminal fraud has been indicated so that the obtaining of evidence will not be practically impossible.

3. Finally the case committee must be assured and convinced that the complainant is anxious to see his case through to a prosecution and not merely desirous of employing the association as a club to force a compromise settlement and thereby obtain cash and clear up a case without delay.

The foregoing procedure has worked satisfactorily. Close adherence to it has prevented the acceptance of cases that would have depleted the Credit Protection Fund without any effective accomplishment and has had a consequent deterrent effect upon habitual bankrupts, bankruptcy rings and those persons who might be planning to stage a bankruptcy.

The amended bankruptcy law will greatly assist in the simplification and dispatch of the work of the department. This law will make it more difficult to make collusive settlements and make it less difficult to punish the bankrupt who conceals his assets. Besides, the penalty for violation of the national bankruptcy act is increased to five years imprisonment.

Results Attained

Without the assistance of a large fund and with a department of limited scope the National Association of Credit Men in eight years obtained the results shown in table 1.

After more than 60 per cent of the fund had been paid in to the association, the Credit Protection Department was reorganized and in operation by June 1, 1925. Court activity was low at this time and at first there was not much that could be done. However table 2 shows what was accomplished with the fund from June 1, 1925 to March 31, 1926.

Perhaps the work of the department in its two divisions during the month of March alone will give a better idea of what can be accomplished with a fund of this sort in running the coyote out of the ranges of honest business. Table 3 gives a picture of a month's work. In tables 2 and 3 results obtained in the Metropolitan District, which embraces the City of New York, are shown separately.

The Credit Protection Department, which is responsible for the operation of the fund, proceeds with a case as follows:

After acceptance on the general basis of the three tests mentioned in the foregoing, investigators are assigned to the case. When sufficient evidence is in hand and witnesses lined up, the case is put before a United States Attorney in whose district the crime occurred. The United States Attorney then attends to the prosecution of the criminal bankrupt.

Some members who have been solicited for subscriptions to the fund, have felt that bankruptcy frauds were losses naturally incident to conducting a business and that the resulting losses could be shifted to the consumer. This attitude is economically unsound. Only in rare instances can the burden be passed on to the consumer. And while some

business men labor under a misconception about who pays the cost of bankruptcy frauds, they can never be induced seriously to combat the credit coyote.

Losses Not a Fixed Charge

As the losses through commercial frauds are not evenly distributed throughout business, they do not represent a fixed charge like a tax or overhead expense that can be passed on to the consumer. Fraud losses vary greatly between business concerns so that where business is operating on a strictly competitive basis the loser cannot attempt to pass the loss on to the consumer in the price of his goods which would then be higher than the prices quoted by his competitors.

There are some exceptions to this general rule, however. In businesses that operate in such a manner that they can charge a monopoly price, which may be what the traffic will bear or a low price which in the long run creates a larger profit than a high price, the fraud loss, in most instances, can be passed on to the consumer by an increase in price. This would be true in businesses which control patents or produce a highly specialized line of goods that are not made of equal quality by any other concern.

Even where credit insurance may be resorted to, the cost cannot be entirely escaped, for the losses that would result to policy holders would be paid by all the insured; and the premiums that would pay the losses would, as indicated before, come from the merchant's profits.

One can get an idea of another cost that is attached to fraud by learning that in seven years the Credit Protection Department of the National Association of Credit Men spent nearly a half million dollars in investigating credit crooks and bringing evidence before Federal and district attorneys. Besides this, some of the 140 local associations that are affiliated with the National Association spent considerable sums in similar independent work.

Cost of Investigation

Six cases handled by the association that were chosen at random indicate that the fraud cost of investigation averages about $600 for each case. We must bear in mind also that creditors' committees under their own initiative conduct similar work from time to time, which runs into large sums of money. The Board of Trade of San Francisco has done this sort of work from time to time and has in fact set aside a sum of money for prosecutions in San Francisco and its environs. These costs, which I have just recounted roughly, all come out of the profits of business and they are spent, of course, in the hope that assets may be recovered to reduce the loss to business.

The association does not expect a great increase of cases. Already there have been discovered indications of a marked tendency by bankrupts, who might ordinarily resort to crime, to lay their difficulties before the association which conducts adjustment bureaus for just such matters.

But, the fund exists not as a device to "build up a business" in prosecuting merchants, but as a danger sign on the highways of commerce which advises business men to keep to the right.

TABLE 1—RECORD OF CREDIT PROTECTION DEPARTMENT FOR EIGHT YEARS PRECEDING FUND

No. of cases accepted	834
No. of indictments	559
No. of convictions	224
Amount of assets recovered	$462,000
Cost of work of department	$308,000

TABLE 2—RECORD OF CREDIT PROTECTION DEPARTMENT SINCE THE FUND WENT INTO OPERATION

	Eastern Division		Central Division	Total for Entire Department
	N. Y. C. District			
No. of convictions since June 1, 1925	23	42	20	62
No. of indictments since June 1, 1925	91	137	187	324
No. of indictments pending	59	98	160	258
No. of cases accepted since June 1, 1925	197	336	317	653
No. of cases pending	107	232	239	471

TABLE 3—RECORD OF CREDIT PROTECTION DEPARTMENT FOR MARCH, 1926

	Eastern Division		Central Division	Total for Entire Department
	N. Y. C. District			
No. of cases accepted	33	50	75	125
No. of indictments	7	14	50	64
No. of convictions	4	10	5	15

NOTE: The above figures were compiled April 12, 1926.